IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 356

WINTER REALTY & CONSTRUCTION CO.,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT OF PETITION

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August 15, 1945.

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WINTER REALTY & CONSTRUCTION CO., *Petitioner,* *against* COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Winter Realty & Construction Co., respectfully prays that a writ of certiorari issue to review an order, judgment and decree of the United States Circuit Court of Appeals for the Second Circuit, entered on May 23, 1945 (R. 115), affirming in part and reversing in part an order and decision of The Tax Court of the United States entered on September 9, 1943 (R. 52-54). A certified transcript of the record is furnished herewith in accordance with Rule 38, Par. 1, of the Rules of this Court.

The opinion of the Tax Court (R. 13-45) is reported at 2 T. C. 38. The opinion of the Circuit Court of Appeals (R. 105-114) is reported at 149 F. (2d) 567.

STATEMENT

Prior to 1932, the City of New York took by condemnation proceedings certain property owned by the petitioner (R. 16) which had a tax basis of $136,564.83. During the years 1932, 1935 and 1936, the City paid to the petitioner the respective net amounts of $160,092.81,* $125,735.57 and $101,116.25, aggregating $386,944.63, as compensation (exclusive of interest) for the property taken (R. 17, 41). Gain upon such awards was accordingly realized as follows (R. 17):

1932	$ 23,527.98
1935	125,735.57
1936	101,116.10**

The first award was received on May 12, 1932, in the net amount of $160,092.81 (R. 17, 41). Prior to the end of 1932, the petitioner made an application for permission to establish a replacement fund which was received but apparently lost (R. 19, 36). After making several inquiries about the first application, the petitioner made a second application to establish a replacement fund in 1937 (R. 22, 36). Neither of such applications was ever acted on by the Commissioner of Internal Revenue (R. 36, 37).

In closing its books for the year 1932, the petitioner set up on the liability side of its ledger an account called

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*The actual net amount paid in 1932 was $160,292.81, but since the Commissioner's determination omitted a $200 item, the lower amount is used. Neither party makes any issue of this discrepancy.

**Although the correct amount of gain was $101,116.25, the Commissioner claimed a tax on only the lesser figure of $101,116.10.

"replacement fund" in the full amount of the net condemnation award received in 1932 (R. 19). At the time the petitioner filed its 1932 income tax return, it also stated in an accompanying letter that it had set up a figure in such return headed "replacement fund", and that it was the petitioner's intention "to replace same in property similar or related in service or use to the property so converted; or, in the acquisition of control of corporation owning such other property" (R. 20).

In 1935, the petitioner received an additional award in the net amount of $125,735.57, and thereupon increased the amount of its account captioned "replacement fund" by the amount of the net award plus assessments (R. 21). Similarly, the petitioner increased the amount of such account by the amount of the net award of $101,116.25 which it received in 1936, plus assessments (R. 17, 21).

The petitioner forthwith invested $190,735.57 of the awards in real estate mortgages which were marked "replacement fund" (R. 21, 70).

The Statute

The applicable statute is § 112(f) of the Revenue Acts of 1932, 1934 and 1936 (47 Stat. 169, 48 Stat. 860, and 49 Stat. 1648, respectively). The section is identical in all three Acts, and reads as follows:

> "(f) INVOLUNTARY CONVERSION.—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money

> which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended."

The Treasury Regulations promulgated pursuant to such section under the above Revenue Acts are set forth in the Appendix to this petition. They provide that the taxpayer "may obtain permission to establish a replacement fund in his accounts", and should "make application" therefor.

The Commissioner's Determination

The Commissioner determined that no part of the awards were expended forthwith in the acquisition of other property similar or related in service or use to the property condemned or in the establishment of a replacement fund (R. 16). He accordingly determined that the entire amount of the capital gain realized for each of the years 1932, 1935 and 1936 was taxable to the petitioner.

The Decision of the Tax Court

The Tax Court decided the case as if the petitioner had obtained "permission to establish a replacement fund" under the Treasury Regulations (R. 37). (The statute does not require such permission). The Tax Court held, however, (against the petitioner) that no replacement fund

was established, mainly upon the ground that a large part of the award money was invested in real estate mortgages, which would probably not be regarded as an ideal investment for the purpose of a replacement fund (R. 38). The petitioner appealed from that portion of the Tax Court's decision.

The Tax Court also found that the petitioner forthwith expended $96,830.19 of the award money "in the acquisition of other property similar or related in service or use to the property so converted", $45,713.94 being thus expended in 1932 and $51,116.25 in 1936 (R. 26). The Commissioner did not press an appeal from those findings.

The Tax Court further held (in favor of the petitioner) that, since the capital gain from the condemnation awards was realized in each of the years of the payment of the awards, namely, 1932, 1935 and 1936, the award received in each year should be traced to see what amount was expended in the acquisition of similar property and that amount was to be applied in determining the amount of gain realized in that year. It held against the Commissioner's contention that the three years should be treated as a unit for the purpose of computing that part of the realized gain which was taxable (R. 40, 41, 51). The Commissioner appealed from that portion of the Tax Court's decision.

The Decision of the Circuit Court of Appeals

Upon the petitioner's appeal, the Circuit Court of Appeals inferentially disapproved the main ground of the Tax Court's decision, namely, that real estate mortgages were not a proper investment for a replacement fund. The Court said that it might "assume that entries on the owner's

books, such as the taxpayer here carried, if supported by bank deposits, or mortgages, would be permissible" (R. 109).

The Circuit Court of Appeals held, however, that the replacement fund set up by the petitioner was not within the statute and the Treasury Regulations *solely* because the Commissioner of Internal Revenue had not given permission to establish the fund. The Court said that "the Commissioner's inaction, however negligent, was certainly not a performance of the condition, and the Commissioner could not be estopped." (R. 110)

Upon the Commissioner's appeal, the Circuit Court of Appeals held that the Tax Court was wrong in the rule of tax accounting which it had used in determining how the amount of the award expended in the purchase of similar property should be applied against the realized gain. In so doing, the Court not only reversed the Tax Court on the question of proper tax accounting, but overruled a previous decision of its own which supported the Tax Court's view (*Wilmore Steamship Co., Inc.* v. *Commissioner*, 78 F. (2d) 667).

JURISDICTION

Jurisdiction of this Court is invoked under § 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. § 348(a)). The date of the order, judgment and decree of the Circuit Court of Appeals for the Second Circuit to be reviewed is May 23, 1945 (R. 115).

QUESTIONS PRESENTED

Two administrative questions of importance are presented.

1. Where a statute provides that gain shall not be recognized where property is involuntarily converted into money which is "forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, * * * expended in the establishment of a replacement fund", and Treasury Regulations promulgated under such statutory provision provide that the taxpayer "may obtain permission to establish a replacement fund in his accounts" and in such a case "should make application to the Commissioner", may the Commissioner, by ignoring applications filed pursuant to the Regulations, prevent the taxpayer from establishing a replacement fund where such fund is otherwise properly established?

2. Where the Tax Court has decided a question of tax accounting, namely, that each taxable year should be considered separately under § 112(f) where three awards are received in three different years, rather than considering all such years as a unit, does a Circuit Court of Appeals have the power to reverse such a holding of the Tax Court under the rule of *Dobson* v. *Commissioner,* 320 U. S. 489?

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT

1. The Circuit Court of Appeals has decided an important question of Federal administrative law which has not been, but should be, settled by this Court, namely, whether a Federal administrative officer (who by his own regulation prescribes that a taxpayer should ask permission before the taxpayer may have a privilege given to him by the statute) may, by simply ignoring applications for such permission and not acting thereon, deprive the taxpayer of the privileges which the statute prescribes.

2. The Circuit Court of Appeals has decided a Federal question in a way probably in conflict with applicable decisions of this Court, particularly *Dobson* v. *Commissioner*, 320 U. S. 489, in that it has reversed a holding of the Tax Court upon a question of proper tax accounting.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Judicial Circuit, sitting at New York, New York, commanding said Court to certify and send up to this Court, on a date to be designated, a full and complete transcript of the record and of all proceedings in the Circuit Court of Appeals had in this case, to the end that this case may be reviewed and determined by this Court; that the order, judgment and decree of the Circuit Court of Appeals be reversed; and that your petitioner be granted such other and further relief as may seem proper.

WINTER REALTY & CONSTRUCTION CO.,
Petitioner,

By

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August 15, 1945.

BRIEF IN SUPPORT OF PETITION

I. IT IS IMPORTANT THAT THIS COURT DECIDE WHETHER A CITIZEN MAY BE DEPRIVED OF A PRIVILEGE PRESCRIBED IN A STATUTE, BY MERE INACTION OF AN ADMINISTRATIVE OFFICER, WHERE THE CITIZEN HAS COMPLIED WITH ALL PREREQUISITES TO ACTION BY SUCH ADMINISTRATIVE OFFICER.

§ 112(f) of the Revenue Acts of 1932, 1934 and 1936, provided that where property was involuntarily converted into money which was forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the establishment of a replacement fund, no gain or loss should be recognized. The Treasury Regulations provided that the taxpayer might obtain permission to establish a replacement fund in his accounts, and in such a case should make application to the Commissioner. The taxpayer complied with all the provisions of the Regulations which were to be complied with by it and filed two separate applications for the establishment of a replacement fund. The Commissioner acted upon neither application.

The basis of the decision of the Circuit Court of Appeals was that the taxpayer had set up a replacement fund in its accounts, but that because of the negligent inaction of the Commissioner, the taxpayer had not "established" a replacement fund and was deprived of the privileges which the statute prescribed. In other words, under that decision, the Congressional purpose in enacting a relief provision can be completely subverted by negligent inaction on the part of an administrative officer. A replacement fund can

never be established "forthwith" if the Commissioner negligently fails to act on applications for permission to establish such a fund.

In view of the increasing complexity of the Federal laws, and the increasing tendency of Congress to extend the rule-making power of Federal administrative officers, it is important that this Court should decide whether a citizen may be deprived of a right given by a statute simply because of the negligent inaction of a Federal administrative officer, where that citizen has complied with all prerequisites to action by such administrative officer.

II. UNDER THE RULE LAID DOWN BY THIS COURT IN THE *DOBSON* CASE, THE CIRCUIT COURT OF APPEALS IMPROPERLY REVERSED THE TAX COURT UPON A QUESTION OF TAX ACCOUNTING.

The net award received by the taxpayer in 1932 was $160,092.81, against which was applied its tax basis of $136,564.83, leaving a realized gain of $23,527.98. The Tax Court found that $45,713.94 of such net award received in 1932 was forthwith expended in the acquisition of property similar or related in service or use to the property condemned.

Of the net award of $125,735.57 received in 1935, the Tax Court found that no part had been invested in similar property. Of the net award of $101,116.25 received in 1936, the Tax Court found that $51,116.25 was invested in similar property.

The last sentence of §112(f), during the years here in question, read as follows:

> "If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended."

The Tax Court accordingly decided that since only $45,713.94 of the net award of $160,092.81 received in 1932 was expended in similar property, leaving an unexpended portion of $114,378.87, the entire realized gain of $23,527.98 must be recognized. Applying the same theory, the entire gain of $125,735.57 realized in 1935 must be recognized. However, of the $101,116.10 received in 1936, $51,116.25 was expended in similar property. Accordingly, the Tax Court held that the recognized gain could not exceed the unexpended portion, or $50,000. The Tax Court explains its computation in a separate memorandum (R. 47-51). Such a rule of computation had been approved by the Circuit Court of Appeals for the Second Circuit in *Wilmore Steamship Co., Inc.* v. *Commissioner*, 78 F. (2d) 667.

The Commissioner, however, challenged the Tax Court's computation for the year 1936. He took the position that all three years should be treated as a unit for the purpose of determining the unexpended portion of the awards and that therefore not only should the unexpended portion of the 1936 award, namely, $50,000, be used in determining the 1936 taxable gain, but also the unexpended portion of the 1932 award and the 1935 award.

The Circuit Court of Appeals reversed the Tax Court and adopted the Commissioner's position. It overruled the *Wilmore Steamship* case.

§ 112(f) was amended by the Revenue Act of 1942, 56 Stat. 798, (§ 115(e)) to adopt the Commissioner's theory. The last sentence of § 112(f) now reads:

> "If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain)."

However, that amendment was applicable only to taxable years beginning after December 31, 1941. See § 101 of the Revenue Act of 1942. It is not applicable to the years here involved.

In *Dobson* v. *Commissioner,* 320 U. S. 489, this Court laid down the rule that a Circuit Court of Appeals has no power to reverse the Tax Court on questions of proper tax accounting. This Court said (pp. 506-7):

> "The error of the court below consisted of treating as a rule of law what we think is only a question of proper tax accounting."

In the *Dobson* case the question was also whether events in previous taxable years could affect the taxability of an amount received in a later taxable year. The taxpayer there had purchased certain stock in 1929 and sold it at a loss in 1930 and 1931. Later he learned that he had been induced to purchase the stock through fraudulent representations. In 1939 he recovered in a suit against the seller. The question was whether the losses in 1930 and 1931 could be considered in determining the taxable status of the recovery in 1939. The Tax Court held that they could. It is implicit in this Court's opinion that had the decision of the Tax Court been to the contrary, the Circuit Court of Appeals would not thereby have been given power to reverse it.

In the instant case, the Tax Court held that what was done with the awards received in 1932 and 1935 could not

affect the taxability of the award received in 1936. This is just as much a matter of proper tax accounting as was the issue involved in the *Dobson* case and the Circuit Court of Appeals should have no more power to reverse the Tax Court.

During the year here in question, namely, 1936, there was, to quote this Court's opinion in the *Dobson* case (320 U. S. 489, 506), "no statute or regulation having the force of one and no principle of law" compelling the Tax Court to hold that what was done with the awards received in 1932 and 1935 affected the taxability of the award received in 1936. When the statute was changed in 1942, the Senate Finance Committee cited the holding in the *Wilmore Steamship* case as the reason for the change in the rule made by the statute (Sen. Rep. No. 1631, 77th Cong., 2nd Sess. p. 121). Whereas the statute involved in the instant case provides that the gain should be recognized in an amount "not in excess of" the money which is not so expended, the Revenue Act of 1942 changed the rule so that the gain was recognized "to the extent of" the money which is not so expended, regardless of whether such money is received in one or more taxable years.

In the instant case, the Circuit Court of Appeals, contrary to the *Dobson* rule, reversed the Tax Court on a question of proper tax accounting, i.e., whether transactions in prior years should be considered in computing the taxable gain for 1936.

Conclusion

The writ should be allowed (1) because the case presents an important question of Federal administrative

law, and (2) because the decision below is in direct conflict with the decision of this Court in the *Dobson* case.

Respectfully submitted,

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August 15, 1945.

APPENDIX

Articles 579 and 580 of Treasury Regulations 77, promulgated under the Revenue Act of 1932, read as follows:

"Art. 579. Involuntary conversion of property. —Section 112(f) deals with cases in which property is compulsorily or involuntarily converted into similar property, or into money, as a result of fire, shipwreck, theft, condemnation, or similar causes enumerated in the Act. If the property so destroyed, stolen, seized, or condemned is replaced in kind by similar property or property related in service or use, no gain or loss is recognized. If, however, the original property is compulsorily or involuntarily converted into money, gain or loss will be recognized unless the money is forthwith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended—

(1) In the acquisition of other property similar or related in service or use to the property so converted,

(2) In the acquisition of control of a corporation owning such other property, or

(3) In the establishment of a replacement fund.

If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended. See article 601 for the basis for determining gain or loss from the sale or other disposition of the property so acquired.

"Art. 580. Replacement funds.—In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. (See section 1126 of the Revenue Act of 1926.) The estimated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy."

Article 112(f)-1 and Article 112(f)-2 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, read as follows:

"Art. 112(f)-1. Reinvestment of proceeds of involuntary conversion.—In order to avail himself of the benefits of section 112(f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112(f) can not be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes. [This paragraph is as amended by T. D. 4698, XV-2 C. B. 159 and T. D. 4951, 1939-2 C. B. 110.]

The provisions of section 112(f) are applicable to property used for residential or farming purposes.

The proceeds of a use and occupancy insurance contract, which by its terms insured against actual

loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are submitted would have been.

There is no investment in property similar in character and devoted to a similar use if—

(1) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(2) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(3) The owner of a requisitioned tug uses the proceeds to buy barges.

[(4) An award for property taken for street widening is applied toward paymert of special assessments for benefits accruing to the remaining property.]*

It is incumbent upon a taxpayer 'forthwith' to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.

"Art. 112(f)-2. Replacement funds.—In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received

* The bracketed provision above noted is eliminated from the Regulations by T. D. 4951, 1939-2 C. B. 110.

shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. See section 1126 of the Revenue Act of 1926 (paragraph 31 of the Appendix to these regulations), providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. The estimated additional taxes, for the amount of which the applicant is required to furnish security, should be computed at the rates at which the applicant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy."

Articles 112(f)-1 and 112(f)-2 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, are similar to the above-quoted provisions of Treasury Regulations 86.

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 356

WINTER REALTY & CONSTRUCTION CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 13–45) is reported at 2 T. C. 38. A memorandum (R. 47–51) accompanying an order of the Tax Court denying the Commissioner's motion to vacate and modify its opinion is not reported. The opinion of the Circuit Court of Appeals (R. 105–112) is reported at 149 F. 2d 567.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 23, 1945. (R. 112–113.) The

petition for a writ of certiorari was filed on August 22, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the Circuit Court of Appeals erred in affirming the decision of the Tax Court that the taxpayer had not, within the meaning of Section 112 (f) of the applicable Revenue Acts, established a replacement fund and that, accordingly, it could not postpone the taxation of the entire gain realized by the taxpayer when its property was taken in a condemnation proceeding.

2. Whether the Circuit Court of Appeals erred in reversing the Tax Court and in holding that the Tax Court had erroneously construed the provisions of Section 112 (f) of the Revenue Act of 1936 with respect to the manner in which that section provides that gain is to be taxed.

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statutes and Regulations involved are set out in the Appendix, *infra*, pp. 19–26.

STATEMENT

The following are the facts which were found by the Tax Court (R. 15–33):

Taxpayer is a corporation with its principal office in Flushing, New York. Its tax returns,

which were made on the accrual basis, were filed with the Collector at Brooklyn, New York, for the years here in controversy. (R. 15.) On November 4, 1931, the City of New York, as a result of condemnation proceedings previously instituted, acquired title to certain property which had been owned by the taxpayer and which consisted of improved real estate. (R. 16, 18–19.) The amount of the awards with respect to certain of the parcels was in litigation; as a result, taxpayer received payments on the awards during the years 1932, 1935 and 1936. (R. 17–18.)

The amounts of the award payments (less collection fees and special assessments) received by taxpayer were as follows (R. 17, 48): [1]

1932	$160,292.81
1935	125,735.57
1936	101,116.25
Total	387,144.63

Taxpayer realized capital gain on account of the condemnation awards as follows (R. 17): [2]

1932	$23,527.98
1935	125,735.57
1936	101,116.10
Total	250,379.65

[1] These figures include an award of $200 received in 1932 which the Commissioner did not include in the taxpayer's income for that year. Also, the Commissioner included, in 1936, fifteen cents less than the amount actually received. No issue was raised before the Tax Court respecting these discrepancies. (R. 17, fn. 1.)

[2] These figures show the gain as calculated by the Commissioner. See fn. 1, *supra*.

In 1932, taxpayer's manager went to the revenue office in Brooklyn and secured application blanks to establish a replacement fund. The application, which was not accompanied by a completed bond, was filled out in triplicate and mailed to the Brooklyn office. Later, through a representative, taxpayer made inquiry concerning the application, but it was never located. That application was not acted upon by the Commissioner. (R. 19.)

In closing its books for 1932, taxpayer set up on the liability side of its ledger an account entitled "Replacement Fund" in the amount of $160,292.96. This, except for a discrepancy of fifteen cents, represented the total of three award installments received in 1932, less the collection fees paid in that year. (R. 19.)

When filing its tax return on March 15, 1933, taxpayer addressed a letter to the Collector at Brooklyn which pointed out that in the return there was a figure entitled "replacement fund" which represented 60 per cent of the City's appraisal of the amount of the award which had not yet been fully paid. (R. 19–20.) The letter continued (R. 20):

> It is the intention of * * * [the] corporation, upon receipt of the balance of the award, to replace same in property in similar or related in service, or use of the property so converted; or, in the acquisition of control of corporation owning such other property.

In 1935, taxpayer increased the amount of the account captioned "Replacement Fund" from $160,292.96 to $291,451.72, this increase representing the net amount of the award installment received in 1935. A similar increase was made in 1936 to reflect the amount received in that year. (R. 21.)

On February 3, 1937, taxpayer filed with the Commissioner of Internal Revenue an "Application to Establish a Replacement Fund" on Form 1114. It did not refer to the prior application made in 1932. The application stated that the kind of replacement intended was "Offices, stores and apartments". It indicated as steps already taken "proceeds partially reinvested—buildings now under construction". Also, the application stated that 1937 was the date replacement would be completed. (R. 22–23, 65–66.) The application was accompanied by a surety bond which was not signed. (R. 23.) This application has never been approved by the Commissioner and the surety bond has never been completed. (R. 23.)

On February 19, 1937, the Commissioner addressed a letter to taxpayer which acknowledged receipt of the application and stated that it was being referred to the Internal Revenue Agent in Charge at Brooklyn, New York, for verification and comment and that upon receipt of his report the matter would receive prompt attention. (R. 23–24.)

The taxpayer did not segregate or set apart the award money when received. Instead, the money was deposited in taxpayer's general bank account along with the money it received from other sources. Checks against the account were drawn, from time to time, during the years in question, for payment of the replacement properties acquired and also for the payment of taxpayer's obligations of every kind, including current expenses, dividends, and expenditures for capital investment. (R. 26.)

Out of the award money received in 1932, taxpayer spent $45,713.94 for the acquisition of other property similar or related in services or use to the property condemned. (R. 26.) No part of the award money received in 1935 was so expended. Of the award installment received in 1936, $51,116.25 was used for the acquisition of replacement property. (R. 26.) The total amount thus expended was $96,830.19. (R. 26.)

On November 8, 1935, taxpayer purchased a mortgage for $150,000. This purchase, to the extent of $125,735.57, was made from the award money received November 7, 1935. On May 4, 1936, taxpayer purchased another mortgage for $50,000. This purchase was made out of the award installment received on May 4, 1936. Both mortgages are outstanding. (R. 21.) These mortgages appeared in taxpayer's balance sheets as an asset under "Mortgages Receivable." (R. 21, 22.)

The taxpayer, in filing its tax returns for the years in question, did not report any part of the realized gain in its net income.

On March 6, 1941, the Commissioner mailed to the taxpayer a notice of deficiencies in income and excess profits tax resulting from, among other things, the failure of taxpayer to have included in its returns the capital gain realized in the years and in the amounts set forth above. The deficiency notice stated that the realized gain was required to be recognized because the taxpayer had not forthwith expended the proceeds of the award in the acquisition of other property similar or related in service or use to the property condemned, or in the acquisition of control of a corporation owning such property, or in the establishment of a replacement fund, in accordance with the provisions of Section 112 (f) of the applicable Revenue Acts. (R. 16, 24.)

The taxpayer sought a redetermination of the deficiencies before the Tax Court. The Tax Court found that a replacement fund had not been established but that a portion of the award money had been expended in the acquisition of replacement property, as shown above. It determined that gain was to be recognized in the following amounts (R. 41, 48):

1932	$23,527.98
1935	125,735.57
1936	50,000.00
Total	199,263.55

The deficiencies in taxpayer's income and excess profits tax resulting from the conclusions of the Tax Court respecting this issue (and resulting from other issues decided by the Tax Court which are not now presented) were entered in the decision of the Tax Court dated September 9, 1943. (R. 52–54.)

The Commissioner, by petition for review filed December 7, 1943, sought review by the Circuit Court of Appeals of the Tax Court's decision insofar as it ruled that the amount of gain to be recognized in 1936 was $50,000 rather than $101,116.10, as determined by the Commissioner. (R. 2, 3–6.)

The taxpayer, by petition for review filed December 9, 1943, sought review of the Tax Court's decision in its holding that any part of the gain was required to be recognized. (R. 2, 7–12.) The cross appeals, by stipulation of the parties, subject to the approval of the appellate court, were consolidated for review.

The Circuit Court of Appeals affirmed the decision of the Tax Court in its holding that the taxpayer had not established a replacement fund and that the recognition of no part of the gain could be postponed on that account. It reversed the decision of the Tax Court so far as it held that Section 112 (f) of the Revenue Act of 1936 required that only a portion of the gain realized in that year be taxed. (R. 105–112.)

ARGUMENT

1. The first issue framed by the petition for certiorari (p. 7) seeks review of a question whose resolution would not be decisive of this case. Further, the absence of any conflict in decisions and the unimportance of the question require that the petition be denied.

The question, as it is stated by the taxpayer, is (Pet. 7)—

> may the Commissioner, by ignoring applications filed pursuant to the Regulations, prevent the taxpayer from establishing a replacement fund where such fund is otherwise properly established?

As will be shown, however, the assumption that the fund was otherwise properly established is directly contrary to what was decided below. Also, as it is stated by the taxpayer, the question ignores the fact that even if the Commissioner had actually granted the applications, the circumstances of this case would still have prevented the taxpayer from postponing the taxation of the gain which it had realized.

The decision of the Tax Court actually removed any objection which the taxpayer reasonably could voice respecting the failure of the Commissioner to grant permission for the establishment of a replacement fund. That is, the Tax Court decided

the case "as if" authority to establish the fund had been obtained from the Commissioner. Even on that assumption, the Tax Court was impelled to conclude that the taxpayer did not in fact proceed to use the award money to establish a replacement fund. Thus, even if the Commissioner had actually authorized the establishment of a replacement fund, the taxpayer's failure to do so inevitably leads to the conclusion that the gain which it realized was required to be recognized for tax purposes precisely as the courts below held.

The taxpayer's contention that it had established a replacement fund rested on two alternative arguments. First, it asserted that all the award money was invested in such a fund because it had entered a bookkeeping liability on its balance sheets in that amount and contended that it was not necessary that identifiable assets exist which would balance the entry and which had been acquired with the award money for the purpose of ultimate investment in replacement property. The Tax Court rejected this argument. (R. 38.)

The taxpayer's second contention was that it had invested in a replacement fund, at least to the extent that a portion of the award had been invested in certain real estate mortgages. The Tax Court ruled against this argument, too, hold-

ing that these particular mortgages had "no relation to a replacement fund" and that they had "not been designated in any way as representing a replacement fund." (R. 38.) The Tax Court also observed (R. 38):

> Furthermore, mortgages would probably not be regarded as an ideal investment for the purpose of a replacement fund of this character because they might not be readily convertible when the time for actual replacement arrived.

The decision of the Circuit Court of Appeals has been altogether misconceived by the taxpayer. It did not decide the case "*solely* because the Commissioner of Internal Revenue had not given permission to establish the fund", as the petition asserts (p. 6), and its opinion cannot be construed as having (Pet. 5) "inferentially disapproved the main ground of the Tax Court's decision, namely, that real estate mortgages were not a proper investment for a replacement fund."

Nowhere does the opinion of the Circuit Court of Appeals show any disagreement with the reasons advanced by the Tax Court for its decision on this issue. The court below merely expressed additional reasons why the Tax Court's decision was required to be affirmed; it did not, in any way, express doubt respecting the validity of the grounds relied on by the Tax Court. Thus, the

Circuit Court of Appeals, by specifically pointing to the requirements of the Regulations that the compensation must be held in a fund and by upholding their validity against the taxpayer's objections, denied the taxpayer's contention, vigorously renewed on appeal, that its book entries alone were sufficient to constitute a replacement fund.

We also deny that the Circuit Court of Appeals rejected the Tax Court's conclusion that the taxpayer had not, as a matter of fact, invested a portion of the award money in mortgages with the intention that they serve as a temporary investment to be used ultimately for the acquisition of replacement property, or that it overruled the finding that, in this case, the mortgages did not have any relation to the replacement fund. Nor did the court below inferentially disapprove the Tax Court's additional observation (which the taxpayer exalts as being "the main ground" of the Tax Court's decision (Pet. 5)) that real estate mortgages would probably not be an ideal investment for a replacement fund. The Circuit Court of Appeals did not decide that these mortgages were a proper investment or that they did constitute a replacement fund; it only stated that, even if they were proper assets, the taxpayer would still be unable to prevail on account of the additional reason set forth in its opinion, namely,

that the Commissioner actually had not given permission for the establishment of any fund. In this respect, the Circuit Court of Appeals stated (R. 108):

> The form of the "fund" is not prescribed, and, arguendo, we may assume that entries upon the owner's books, such as the taxpayer here carried, if supported by bank deposits, or mortgages, would be permissible.

It should be noted that by inadvertently omitting the word "arguendo" from the above quotation, (Pet. 5–6), the taxpayer has fallen into the error of confusing an assumption which the court made only for the sake of discussion, with an express holding in the decision.

Since the basis for the decision of the Tax Court stands unchallenged either by the petition for certiorari or by the opinion of the Circuit Court of Appeals, it must be apparent that the taxpayer is seeking review of an academic question. Even if the additional ground advanced by the Circuit Court of Appeals were erroneous, the decision below would still require affirmance on the reasons given by the Tax Court and which are not now brought forward in the petition for certiorari as furnishing a basis for further review.

The question which the petition presents is academic for yet another reason. The Commissioner's non-action could not be held, under any theory, to give the taxpayer the right to establish a replacement fund in any broader terms than the taxpayer itself requested. In its application to establish a replacement fund, the taxpayer represented that it would complete the acquisition of replacement property in 1937. (R. 22–23, 37, 66.) If the Commissioner had granted the application, the taxpayer would not have had permission to establish the fund for any longer period or to delay the acquisition of replacement property beyond 1937. Quite clearly, the taxpayer is not entitled to be in any better position today than it would have occupied if the application had been granted as requested. Yet, except to the extent specifically found by the Tax Court (R. 41–42), the taxpayer had not acquired the replacement property by April, 1942, the date of the hearing before the Tax Court. Thus, even if the taxpayer's application had been granted in the terms requested, its failure to acquire replacement property long after the expiration of the permission would require that the gain be taxed.

In addition, it may be observed that the redetermination of a tax deficiency under Section 272 of the Internal Revenue Code is scarcely an appropriate proceeding in which to test the right of a

taxpayer to secure administrative consideration of his application to establish a replacement fund. Mandamus might have been seasonably applied for to that end; but even in that event the writ could not have been used to order the Commissioner to exercise his discretion in a particular manner or to compel him to grant the application. *I. C. C.* v. *United States,* 289 U. S. 385, 394; *Wilbur* v. *United States,* 281 U. S. 206, 218.

No conflict in decisions exists. The issue presented for review is not only not decisive of the case, but is unimportant as is evident from the fact that this problem appears to be unique in the 24-year history of the administration of similar provisions in all Revenue Acts, begininng with the Revenue Act of 1921. Moreover, the Circuit Court of Appeals properly affirmed the decision of the Tax Court that the taxpayer had not, within the meaning of the statutes and the regulations, established a replacement fund.

2. The Circuit Court of Appeals did not exceed its powers of review under Section 1141 (c) of the Internal Revenue Code by reversing the Tax Court for having determined the taxpayer's taxable gain in an erroneous manner.

Section 112 (f) of the applicable Revenue Acts (Appendix, *infra*) deals expressly with the extent to which gain realized on an involuntary conversion should be recognized for tax purposes when

the proceeds have been partially reinvested in replacement property. The Tax Court believed "that it was the intent of the statute" (R. 49) that where a single condemnation award is paid in installments over several years, the amount of gain subject to tax should be different than it would have been if the entire award had been paid in one taxable year. Accordingly, the Tax Court, in determining the amount of the taxpayer's gain to be recognized on the receipt of each installment of the award, felt that it was obliged by Congress to refuse to take notice of how much of the money, represented by the previous installments of the award, had not been expended in the purchase of replacement property. The Circuit Court of Appeals, however, held that such a construction of Section 112 (f) was erroneous and that Congress did not intend such a result.

We believe it quite plain that the construction of the statute adopted by the Tax Court was not a permissible one. We also believe that the reasoning of both the majority and concurring opinions in *Trust u/w of Bingham* v. *Commissioner,* decided by this Court June 4, 1945, not yet reported, supports the position that such a construction of the statute is subject to correction on review.

The decision of the court below does not depart from *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, with which the

taxpayer asserts a conflict. (Pet. 8, 14.) In the *Dobson* case it was the absence of any governing provision of a statute or regulation which led this Court to conclude that the Tax Court had discretionary authority under Section 272 (f) of the Revenue Act of 1928 to determine from prior years whether the taxpayer there had a return of capital or received ordinary income. It was expressly recognized, however (pp. 492–493), that if the method employed by the Tax Court in the *Dobson* case had been forbidden by the applicable statutes and Regulations, its—

> decision would not be "in accordance with law" and the Court would be empowered to modify or reverse it. Whether it is true [that the applicable statutes and regulations properly interpreted forbid the method followed] is a clear-cut question of law and is for decision by the courts.

If, as the Circuit Court of Appeals held, Section 112 (f) itself requires the Tax Court to determine taxable gain in one particular manner, then there is no choice about methods and the Tax Court does not possess any discretion whether it will or will not inquire into previous years. The very reasons why the Tax Court's exercise of discretion was considered to be entitled to finality on review in the *Dobson* case do not exist in this situation. Whether Section 112 (f) is or is not an applicable statute forbidding the method of de-

termination employed by the Tax Court is, as pointed out in the *Dobson* case, a clear-cut question of law for decision by the courts on review.

CONCLUSION

For the reasons expressed above, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1945.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(f) *Involuntary Conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(9) *Involuntary Conversion.*—If the property was acquired, after February 28, 1913, as the result of a compulsory or in-

> voluntary conversion described in section 112 (f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

Sections 112 (f) of the Revenue Act of 1932, c. 209, 47 Stat. 169, and the Revenue Act of 1934, c. 277, 48 Stat. 680, are identical with Section 112 (f) of the Revenue Act of 1936. Section 113 (a) (9) of the Revenue Act of 1934 and 113 (a) (10) of the Revenue Act of 1932 are substantially the same as Section 113 (a) (9) of the Revenue Act of 1936.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

> ART. 579. *Involuntary conversion of property.*—Section 112 (f) deals with cases in which property is compulsorily or involuntarily converted into similar property, or into money, as a result of fire, shipwreck, theft, condemnation, or similar causes enumerated in the Act. If the property so destroyed, stolen, seized, or condemned is replaced in kind by similar property or property related in service or use, no gain or loss is recognized. If, however, the original property is compulsorily or involuntarily converted into money, gain or loss will be recognized unless the money

is forthwith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended—

(1) In the acquisition of other property similar or related in service or use to the property so converted,

(2) In the acquisition of control of a corporation owning such other property, or

(3) In the establishment of a replacement fund.

If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended. See article 601 for the basis for determining gain or loss from the sale or other disposition of the property so acquired.

ART. 580. *Replacement funds.*—In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. (See section 1126 of the Revenue Act of 1926.) The esti-

mated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

ART. 601. *Property acquired by an involuntary conversion.*—In the case of property acquired after February 28, 1913, as the result of an involuntary conversion described in section 112 (f) and article 579, the basis of the property shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which the conversion was made.

Example: A vessel purchased by A in 1923 for $100,000 is destroyed in 1932, and A receives insurance in the amount of $200,000. Disregarding, for the purpose of this example, the adjustment for depreciation, if A invests $150,000 in a new vessel, taxable gain to the extent of $50,000 would be

recognized. The basis of the new vessel is $100,000; that is, the cost of the old vessel ($100,000) minus the money received by the taxpayer which was not expended in the acquisition of the new vessel ($50,000) plus the amount of gain recognized upon the conversion ($50,000).

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 112 (f)-1 [as amended by T. D. 4951, 1939-2 Cum. Bull. 110]. *Reinvestment of proceeds of involuntary conversion.*—In order to avail himself of the benefits of section 112 (f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112 (f) can not be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.
>
> If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property

and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

The provisions of section 112 (f) are applicable to property used for residential or farming purposes.

The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

There is no investment in property similar in character and devoted to a similar use if—

(1) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(2) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(3) The owner of a requisitioned tug uses the proceeds to buy barges.

It is incumbent upon a taxpayer "forthwith" to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.

ART. 112 (f)-2. *Replacement funds.*—In any case where the taxpayer elects to re-

place or restore the converted property but it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. See section 1126 of the Revenue Act of 1926, as amended (paragraph 31 of the Appendix to these regulations), providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. The estimated additional taxes, for the amount of which the applicant is required to furnish security, should be computed at the rates at which the applicant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

ART. 113. (a) (9)–1. *Property acquired as a result of an involuntary conversion.*—The provisions of section 113 (a) (9) may be illustrated by the following example:

Example: A vessel purchased by A in 1926 for $100,000 is destroyed in 1936 and A receives insurance in the amount of $200,000. Disregarding, for the purpose of this example, the adjustment for depreciation, if A invests $150,000 in a new vessel, taxable gain to the extent of $50,000 would be recognized. The basis of the new vessel is $100,000; that is, the cost of the old vessel ($100,000) minus the money received by the taxpayer which was not expended in the acquisition of the new vessel ($50,000) plus the amount of gain recognized upon the conversion ($50,000). If any amount in excess of the proceeds of the conversion is expended in the acquisition of the new property, such amount may be added to the basis otherwise determined.

Articles 112 (f)–1, 112 (f)–2, and 113 (a) (9)–1 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, are similar to the above-quoted Articles of Treasury Regulations 94.

U. S. GOVERNMENT PRINTING OFFICE: 1945

(27)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 356

WINTER REALTY & CONSTRUCTION CO.,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION

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September 27, 1945.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

WINTER REALTY & CONSTRUCTION CO., *Petitioner,* *against* COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 356

REPLY BRIEF IN SUPPORT OF PETITION

The petition presents two questions:

(1) The effect of the negligent inaction of a Federal administrative officer,* and

(2) Whether the Circuit Court of Appeals, under the *Dobson* case, 320 U. S. 489, had power to reverse the Tax Court on a question of tax accounting.**

The respondent's Brief in Opposition asserts that the decision of the first question would not be decisive of the case and that the question is unimportant. With respect to the second question, it asserts that the decision of the Circuit Court of Appeals was on a question of law.

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*This issue is also presented by the petitions in *Flushingside Realty & Construction Co.* v. *Commissioner,* No. 357, and *Twinboro Corporation* v. *Commissioner,* No. 358.

**This issue is also presented by the petition in No. 357.

I. The Negligent Failure of the Commissioner of Internal Revenue to Act upon the Petitioner's Application was Considered Decisive of the Case by the Circuit Court of Appeals. For this Court to Refuse to Consider that Question would Deprive the Petitioner of any Possibility of Review.

The Tax Court decided the case "as if" the Commissioner had granted permission to establish a replacement fund (R. 37). It found, however, that no fund was established because:

(1) The form of the book entries was not proper (R. 38), and

(2) Although the awards were partially invested in real estate mortgages (R. 21), such investments were not proper investments for a replacement fund (R. 38).

Accordingly, the petitioner's argument in the Circuit Court of Appeals was mainly directed to the above propositions.

The Circuit Court of Appeals refused, however, to decide the case upon the grounds stated by the Tax Court. It said (R. 108):

> "* * * The form of the 'fund' is not prescribed, and, arguendo, we may assume that entries upon the owner's books, such as the taxpayer here carried, if supported by bank deposits, or mortgages, would be permissible. For example, the regulation reads: 'he may obtain permission to establish a replacement fund in his accounts in which * * * the compensation * * * shall be held.' * * *"

And again (R. 109):

> "Since the taxpayer at bar did not get permission, it became entitled to the exemption only so far as it in fact 'expended' the money in buying 'similar property'; for the Commissioner's inaction, however negligent, was certainly not a performance of the condition, and the Commissioner could not be estopped. * * *"

The respondent incorrectly says (Br. 11) that the lack of permission by the Commissioner was an "additional" ground of affirmance. It was the *only* ground of affirmance, the court below having expressly refused to rely upon the grounds stated in the Tax Court's opinion.

We do not mean to state that the Circuit Court of Appeals expressly decided that the Tax Court's views were wrong; its disapproval was only an inferential one derived from its failure to adopt the Tax Court's views as the basis for its own decision. It had two choices:

(1) It could state that it agreed with the Tax Court that the form of the fund and its investment was improper, and add as an additional reason for affirmance the negligent failure to act on the application for permission to establish the fund; or

(2) It could, as it did, "assume" (without deciding) that the Tax Court was wrong in its decision on the form of the fund and the investments, and base its decision *solely* on the failure of the Commissioner to act upon the application.

Accordingly, the petitioner has never had appellate review of the decision of the Tax Court as to the form and

investment of the fund, and it can never have such review unless this Court decides whether the ground upon which the Circuit Court of Appeals *did* decide the case was proper.

II. A Question Involving the Negligent Inaction of a Federal Administrative Officer is an Important One.

The respondent (Br. 15) claims that the question is unimportant because it "appears to be unique in the 24-year history of the administration of similar provisions in all Revenue Acts". We do not doubt that failure on the part of a Federal administrative officer to take any action upon an application for so long a period is unique, but that does not prevent a decision that such action may deprive a citizen of substantial rights from being important. The question is not limited to cases arising out of the Federal revenue laws; it is one of general application to all Federal administrative officers.

Nor is the question academic. The Commissioner's determination was that tax was due from the petitioner because the awards had not been "forthwith" expended in the establishment of a replacement fund (R. 16). He did not base his determination on the theory that the replacement fund had not been expended quickly enough in the purchase of similar property. Of course, as the respondent states (Br. 14), the petitioner "is not entitled to be in any better position today than it would have occupied if the application had been granted as requested", but who is to say what that position would have been? If the Commissioner had acted promptly upon the petitioner's 1932 application and set a time within which the fund should be expended in the purchase of similar property (as is customary), we cannot assume that the petitioner would not have complied.

The respondent also observes (Br. 14) that this proceeding involves the redetermination of a tax deficiency and is not an appropriate proceeding in which to test the petitioner's right to secure administrative consideration of his application to establish a replacement fund. But the petitioner could not have known prior to the Commissioner's determination of its tax liability whether the Commissioner would or would not act upon its applications. By that time, mandamus, at best an uncertain remedy, had become wholly inadequate. As the respondent states (Br. 15), mandamus could not have compelled the granting of permission, and the statute provides that the award be "forthwith" expended in the establishment of a replacement fund.

III. The Method of Accounting Applied by the Tax Court is not Forbidden by the Applicable Statute and Regulations.

The respondent (Br. 15-18) takes the position that the statute and regulations in force in 1936 compelled the Tax Court to hold that what was done with the awards received in 1932 and 1935 affected the taxability of the award received in 1936. But the statute and the regulations are silent on the question of whether the application of awards received in prior years affects the taxability of an award received in 1936.

The respondent claims that the Tax Court and the Circuit Court of Appeals decided a question of law, namely the interpretation of the following sentence contained in Section 112(f) of the Revenue Act of 1936:

> "If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended."

There is obviously no guide in the above quotation to the decision of the question whether each year should be considered separately or several years should be treated together.

All Federal taxes are levied by statute, and, accordingly, in the last analysis, every tax case involves an interpretation of the law. However, as this Court pointed out in the *Dobson* case, 320 U. S. 489, 507, where the statute "gives no inkling as to the correctness or incorrectness of the Tax Court's view * * * we can find no compelling reason to substitute our judgment". In that case as here, the Government urged that the Tax Court's decision was based upon a statutory provision. This Court said, however (p. 503):

> "Viewing the problem from a different aspect, the Government urges in this Court that although the recovery is capital return, it is taxable in its entirety because taxpayer's basis for the property in question is zero. The argument relies upon § 113 (b) (1) (A) of the Internal Revenue Code, which provides for adjusting the basis of property for 'expenditures, receipts, losses, or other items properly chargeable to capital account'. This provision, it is said, requires that the right to a deduction for a capital loss be treated as a return of capital. Consequently, by deducting in 1930 and 1931 the entire difference between the cost of his stock and the proceeds of the sales, taxpayer reduced his basis to zero. But the statute contains no such fixed rule as the Government would have us read into it. * * *"

So here, Section 112(f) "gives no inkling as to the correctness or incorrectness" of the Tax Court's decision on the matter of accounting. The ambiguity of the statute is highlighted by the fact that it was expressly amended in

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rule of accounting and also, perhaps, by court below was first of opinion that the of accounting was the proper one (*Wil-Co., Inc.* v. *Commissioner,* 78 F. (2d)

Respectfully submitted,

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September 27,

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